MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

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FINAL EXAMINATION

1924, 2019/ 2020

BCF7044 – CORPORATE FINANCE

(MBA Part Time)

19 JANUARY 2020
10.00 a.m – 1.00 p.m
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consist of **FOUR (4)** pages (including the cover page).

2. Answer **ALL** questions. The marks distributions are given in parentheses.

3. Write all your answers in the **<u>Answer Booklet</u>** provided.

QUESTION 1 (Total: 29 Marks)

Press Metal Industries Bhd (PMI) is a Malaysian company that involves in the manufacturing and marketing of galvanised steel sheets and related products. The company faced the problem of declining sales in 2015 and 2016 due to economic slowdown and the generally adverse market condition.

During the board meeting held in December 2016, the executive chairman commented that:

> "*Since our company's operating cash flow is affected due to the poor market sentiment, we should consider a new dividend policy to conserve cash. The latest dividends per share that we paid were RM1.85. I think we should reduce our dividend by 60 percent and maintain that lower level for 2017 and 2018 to allow us to pay off some debt. In 2019, we will increase our dividend back to RM1.85, then grow the dividend at 8 percent annually thereafter.*"

The required rate of return on PMI's equity is 11 percent for the foreseeable future.

a) Calculate, using a dividend discount model (DDM) approach, the fair value of PMI's stocks in December 2016 by referring *only* to the new dividend policy described by the executive chairman. (10 marks)

In early 2017, PMI announced the signing of a new marketing agreement that will allow the company to sell its products in China. After PMI announced the new marketing agreement to sell its product in China, several analysts revised their 2017 outlook for PMI.

Reflecting the new marketing agreement, the estimated 2017 average earnings per share (EPS) from the analysts is RM3.19.

One of the analysts observes that PMI's share price rose from RM55.00 to RM75.00 after the new agreement was announced.

b) Calculate the present value of growth opportunities (PVGO) in early year 2017 reflected in PMI's share price after the new marketing agreement was announced. (10 marks)

c) Interpret your result found in part (b) (9 marks)

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QUESTION 2 (Total: 32 Marks)

a) Discuss the non-financial factors influencing the corporate projected income statement (8 marks)

b) An important goal of working capital management is to minimize the length of the cash conversion cycle. Discuss THREE (3) strategies in achieving the goal. (6 marks)

c) Discuss TWO (2) arguments for and against high dividend policy as proposed by the 'Rightists' school of thought. (6 marks)

d) Corporate Finance is the study of the financial aspects of corporations especially about the investing and financing activities.

Required:

(i) List down and discuss FOUR (4) financial policies that involved in developing the financial plans. Support with example respectively. (8 marks)

(ii) Distinguish between internal growth rate AND sustainable growth rate. (4 marks)

QUESTION 3 (Total: 15 Marks)

An Joo Berhad has a target debt-equity ratio of 1.20. Its WACC is 10.78%, and the tax rate is 40%. If An Joo's cost of equity is 16%, what is its pretax cost of debt?

QUESTION 4 (Total: 24 Marks)

Jenny, the CFO of Wework Inc., has just completed an evaluation of a proposed capital expenditure for equipment that would expand the firm's manufacturing capacity. Using the traditional NPV methodology, she found the project unacceptable because $NPV_{traditional} = -\$1,700 < \$0$

Before recommending rejection of the proposed project, she has decided to assess whether there might be real options embedded in the firm's cash flows. Her evaluation uncovered three real options:

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- Option 1: *Abandonment*—The project could be abandoned at the end of 3 years, resulting in an addition to NPV of $1,200.
- Option 2: *Growth*—If the projected outcomes occurred, an opportunity to expand the firm's product offerings further would become available at the end of 4 years. Exercise of this option is estimated to add $3,000 to the project's NPV.
- Option 3: *Timing*—Certain phases of the proposed project could be delayed if market and competitive conditions caused the firm's forecast revenues to develop more slowly than planned. Such a delay in implementation at that point has an NPV of $10,000.

a) Based on the above three real options available, what is the real option's overall expected value if there was a 25% probability that the *abandonment* option would need to be exercised, a 30% probability that the *growth* option would be exercised, and finally a 10% probability that the *timing* option would need to be exercised? (10 marks)

b) Based on your answer in part a), compute the strategic NPV of the proposed project with option. (6 marks)

c) Should Jenny recommend to management with regard to the proposed equipment expenditure? (4 marks)

d) In general, how does the above demonstrate the importance of considering real options when making capital budgeting decisions? (4 marks)

End of Paper